necessary to meet constitutional standards."[16/] Id. at ¶ 97. As the Court noted in the Automatic Refund Decision,[17/] however, the Commission's previous decisions prescribing rates of return clearly establish that it viewed the prescribed rate as the "lowest possible return consistent with [the carrier's] overall responsibility to provide modern, efficient service at reasonable rates." American Telephone & Telegraph Co., 86 FCC 2d 221, 223 (1981), citing AT&T (Docket No. 19129), 38 FCC 2d 213, 226 (1972). Thus, the Commission's attempt to distinguish the Automatic Refund Decision by re-defining the nature of the rate of return prescription cannot cure the basic defect in any automatic refund rule.[18/]

16/ The Commission's earlier decisions have not indicated that it viewed the prescribed rate of return as a constitutional minimum or maximum. There is no constitutional maximum and any constitutional minimum is typically substantially lower than any reasonable rate of return.

17/ See Automatic Refund Decision, supra at 1390.

18/ Moreover, the Commission's attempt to redefine the nature of its rate of return prescription undermines the basis on which it has ordered carriers to refund overearnings. Under Section 208, the Commission can find rates unlawful only if they are unjust or unreasonable. If the prescribed rate of return is not both the permissible maximum and minimum, but a point with a range of reasonable rates of returns, then the rates which resulted in an overearnings are not necessarily unreasonable. Thus, under the Commission's new definition, if the Commission prescribed a rate of return of 12 percent but determined that the zone of reasonableness is between 11 and 13 percent, a LEC's rates would become unreasonable only where they exceeded the upper boundary of the zone of reasonableness, i.e., 13 percent. By definition, the rates could not be found unreasonable if they exceeded the prescribed rate of return by an amount that was less than or equal to the difference between the prescribed return and the upper boundary of the zone the Commission found to be reasonable.

In the Automatic Refund Decision, the Court held that the refund rule violated fundamental principles of ratemaking, since it ensured that "over the long run the carrier is virtually guaranteed to fall short of earning its required target rate-of-return . . . ." Automatic Refund Decision, 836 F.2d at 1390. This unlawful result occurred because carriers were required to refund overearnings in those periods in which their revenues exceeded the prescribed rate of return ("peaks"), but were not permitted to recover any shortfall when they earned less than the prescribed rate of return ("valleys"). 836 F.2d at 1390-91. The Court went on to suggest that the Commission could only require carriers to refund earnings in excess of the prescribed rate of return when the Commission permitted carriers to recover amounts by which they fell short of the rate of return. 836 F.2d at 1392. The refund rule proposed in the Notice is inconsistent with this holding since it would preclude LECs from recovering underearnings and thus would not eliminate the "peaks-and-valleys problem." Accordingly, that rule would violate fundamental principles of ratemaking and be unlawful under the Automatic Refund Decision. Id. at 1388, 1391, 1393.[19/]

[19/] In his concurring opinion, Judge Starr questioned any requirement that carriers refund overearnings. He argued that, except for the specific provisions of Section 204, the regulatory scheme of the Act was forward-looking and any adjustment to rates must be made prospectively. See 836 F.2d at 1394. Thus, a holding in this proceeding that a LEC's interstate access rates are unlawful based on actual earnings levels could constitute (continued...)

Significantly, the Court's reasoning in the Automatic Refund Decision was recently followed by the United States Court of Appeals for the Sixth Circuit in Ohio Bell v. FCC, 949 F.2d 864 (6th Cir. 1992). In that case, the Court set aside a Commission order requiring a number of LECs to refund special access overearnings for the 1985-86 and the 1987-88 monitoring periods. In doing so, the Court held that:

> Plainly, the case now before this Court runs virtually on all fours with A.T.& T. The same analysis applies. If petitioners are required to refund overearnings in the special access category of earning while being precluded from setting off underearnings against overearnings, in the long run petitioners will earn less than the rate of return the Commission deems adequate and necessary to attract investors. Hence the refund order before this court can only be considered arbitrary and capricious.

Id. at 873. Thus, the Automatic Refund Decision and the Ohio Bell decision preclude the Commission from adopting an automatic refund rule.

In urging this position, Centel is aware that the Commission held in MCI v. Pacific Northwest Bell Telephone Company, 5 FCC Rcd. 216 (1990) ("MCI v. PNB"), that the Automatic Refund Decision was not applicable to complaint proceedings under Section 208. The Commission noted that the Automatic Refund Decision involved an automatic refund, while that proceeding

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19/ (...continued)
unlawful retroactive ratemaking. (Starr, concurring) (". . . the Commission 'may not impose a retroactive rate regulation and, in particular, may not order reparations.'" citing Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577 (1980).) See also, New England Telephone & Telegraph Co. v. FCC, 826 F.2d 1101, 1111-13 (D.C. Cir. 1988) ("NET v. FCC") (Buckley, J. dissenting); Ohio Bell, infra.

involved a complaint filed under Section 208. The Commission stated: "The opinion does not address Section 208 complaint proceedings nor purport to alter the statutory scheme of the Act or the remedies Congress established therein." 5 FCC Rcd. at 223.

While that statement is correct, it is, as the Court in Ohio Bell concluded, irrelevant to whether the Commission can require carriers to refund overearnings while absorbing underearnings. The fact that a Section 208 proceeding does not entail an automatic refund requirement ignores the underlying rationale of the Automatic Refund Decision and the Ohio Bell decision that the Commission lacks the power to order refunds or reparations based on a rate prescription where the carrier is also precluded from recovering underearnings. That limitation on the Commission's power applies regardless of whether the Commission is proceeding under Section 204 or under Section 208.[30/]

Similarly, the Commission's reliance in the Notice and in the MCI v. PNB case on NET v. FCC to support its position that it

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[30/] The cases on which the Commission relied to support its position that carriers have been required to make refunds are inapposite here. In those cases, the carriers were not subject to a rate of return prescription, FPC v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962), or the obligation to refund derived from reasons other than that the carrier's rates were unjust or unreasonable. TRT Communications v. F.C.C., 837 F.2d 1535 (D.C. Cir. 1988) (refunds ordered to effect Commission division of revenues; court held statutory scheme separate from that involved here); Communications Satellite Corp. v. FCC, 611 F.2d 883 (D.C. Cir. 1977) (refund required where carrier sought to recover "return deficiencies" -- lost earnings due to underutilization of facilities -- a holding that the "return deficiencies" were not properly put in the rate base.)

has the authority to order refunds where a carrier earned more than its prescribed rate of return is misplaced. Notice at ¶ 98; MCI v. PNB, 5 FCC Rcd. at 222-223. As the Court in Ohio Bell stated:

> [t]hat case establishes that the Commission may regulate rates by establishing rates of return to be incorporated into rate schedules. It does not address the issue of AT&T or this case. The issue is whether a refund rule that requires refunds of overearnings but ignores underearnings is consistent with Commission policy in establishing rates of return. In short, New England Tel. and Tel. is largely irrelevant to the dispositive issue of this case.

Ohio Bell, supra at 873.[31/]

[31/] In MCI v. PNB, the Commission took the position that the NET v. FCC decision holds that refunds can be ordered where a carrier earned more than its prescribed rate of return, even where an accounting order had not been entered. As noted previously, however, the Court in Illinois Bell, supra, held that the Commission may not order refunds under Section 204 of the Act without suspending the rates and issuing an accounting order.

Further, Centel submits that the NET v. FCC decision is wrongly decided and that Judge Buckley's dissent properly states the law. Centel also submits that the NET v. FCC Court's interpretation of the powers granted by Section 4(i) is inconsistent with the holding of the Court of Appeals in American Telephone and Telegraph Co. v. FCC, 487 F.2d 865 (2nd Cir. 1973). In that case, the Court invalidated a Commission order adopted under Section 4(i) which required AT&T to obtain Commission consent before filing a rate change in connection with a tariff that was under investigation. The rule was adopted to give the Commission the opportunity to resolve one rate case before AT&T filed new rates, thereby complicating the pending proceeding. The Court held that, although Section 4(i) gave the Commission broad power to implement the policies of the Act, the Commission's actions had to be consistent with the Act. The Court noted that "[s]ections 203 through 205 of the Act ...establish precise procedures and limitations concerning the Commission's processing of carrier initiated rate revisions" and found that, since those sections provided for carrier-initiated rates, the Commission could not, unless it prescribed rates under Section 205, require AT&T to obtain prior consent to the filing of new rates. Id. at 874; 878-890.

(continued...)

In sum, the decisions in the Automatic Refund Decision, Ohio Bell, and Illinois Bell cases all clearly establish that the Commission's power to order refunds is circumscribed by the Communications Act. Under that Act, it may prescribe and adjust rates on a prospective basis only, unless it complies with the specific requirements of Section 204. Thus, where a carrier exceeds its authorized rate of return, the Commission may order it to file new rates targeted to achieve the authorized rate of return. It may not, under Section 204 or under Section 208, require the carrier to pay refunds for overearnings, except where it also allows the carrier to recover underearnings. As both the Automatic Refund Decision and Ohio Bell demonstrate, any other approach is inconsistent with the rate of return prescription itself.

[31/] (...continued)

That holding applies equally here. The Act incorporates the "filed rate doctrine" and specifies the situations in which the Commission can order a refund, requiring that the Commission suspend any rate and enter an accounting order before a carrier may be required to return revenue derived from lawfully filed rates. See 47 U.S.C. §204. Contrary to the position of the majority in NET v. FCC, Section 4(i) cannot be read to expand those precisely drawn limits.

b. If the Commission Adopts a Refund Rule or Proposes to Enforce its Rate of Return Prescription through Section 208 Proceedings, It Must Substantially Increase Any Buffer Zone and Extend the Enforcement Period to the Entire Term the Rate of Return Prescription Remains in Effect.

For the reasons articulated above and as the Court found in the Automatic Refund Decision,[32] Centel does not believe the Commission can solve the fundamental defects in any refund requirement by tinkering with either the buffer zone or the enforcement period. However, if the Commission concludes that it has the statutory power to require LECs to pay refunds, Centel believes that the Commission must substantially increase the buffer zone and should measure a LEC's rate of return over the full period the prescribed rate remains in effect.

The current buffer zone of 25 basis points is totally inadequate. It does not give the LECs any flexibility if either their cost or demand estimates prove to be inaccurate. Centel submits that, at a minimum, the buffer should be set at 100 basis points above the prescribed rate of return in order to give the LECs a reasonable opportunity to actually realize their authorized rate of return.

Centel also recommends that the Commission should measure compliance with the rate of return prescription over the term the rate is in effect. The current two year monitoring period was adopted at the time the Commission proposed to review, and presumably revise, the rate of return every two years. Thus, it

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[32] 836 F.2d at 1391.

was reasonable to measure whether a LEC was exceeding the authorized rate during a two year period. A similar rationale supports measuring compliance with a rate of return prescription over the term the prescription is in place. Indeed, by extending the period during which LECs are to be evaluated, the Commission will give them additional flexibility to adjust their rates on their own initiative so that they are more likely actually to earn their authorized rate of return. Any other measurement period will increase the prospects that carriers will earn less than their authorized rate as long as the Commission requires refunds of overearnings. As such, it is inconsistent with the rate of return prescription itself.

c. Any Overearnings Should be Calculated at the Total Telephone Company Level

As noted above, the Commission has requested comment on whether any overearnings should be calculated on an overall interstate basis, rather than on an access category basis as in the prior rule.[33] The Automatic Refund Decision and Ohio Bell decision also govern this issue. Those decisions clearly held that the Commission is precluded from requiring refunds based on overearnings for a specific service rather than on a company-wide basis. In the Automatic Refund Decision, the Court noted that the "peaks-and-valleys problem" was not limited to the failure of the carrier to recover losses in a given time period, but extends

[33] Notice at ¶ 100.

to variations in the profitability of business segments of any particular carrier:

> A carrier with profitable and unprofitable business segments may easily find that making refunds on the profitable segments means that it earns less than the required minimum rate of return on its overall operations. . . . Indeed, the Commission itself acknowledged that requiring refunds by business segment 'may prevent a carrier from earning its overall authorized return' within a single two year period.

Id. at 1391.

Indeed, both decisions require that any overearnings be calculated at the corporate level at which investments are made in the LEC. Thus, in the Automatic Refund Decision, the Court stated that, in addition to the problems with the failure of the automatic refund rule to allow carriers to earn the prescribed rate of return, any requirement that carriers disgorge overearnings must produce a just and reasonable effect on the total "regulated business," noting that "[i]nvestors in a carrier, after all, must invest in the carrier as a whole, and not just in one or another of its business segments." Id. at 1392.

Centel asserts that if a LEC is obliged to pay refunds on overearnings, the Court's Automatic Refund Decision requires that those overearnings be calculated at the level reviewed by investors in the LEC's business, that is, at the total telephone company level. For example, there is no publicly traded common stock of any of the Centel telephone companies[34] since Centel Corporation ("Centel Corp.") controls all their common stock.[35] While Centel Corp. also owns other subsidiaries which provide cellular communications services, the telephone operating companies constitute a distinct business enterprise and represent the largest industry segment of Centel Corp.'s businesses. In recognition that investors view the telephone operations as a distinct business, Centel Corp. reports those consolidated telephone company operations separately in its Annual Reports and in other financial documents.

Accordingly, investors in Centel Corp. do not look to any specific operating company or division in deciding whether to invest in the corporation, but rather look to its telephone operations collectively. As such, the Commission must, in order to fairly balance the ratepayers' interests with a LEC's interest in avoiding capital flight, calculate any overearnings by analyzing the aggregate rate of return on interstate access services of all of the holding company's telephone operations.

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[34] Centel Corp. provides local exchange service through its subsidiaries, Central Telephone Company (with divisions in Nevada and North Carolina). Central Telephone Company of Florida, Central Telephone of Illinois, Central Telephone Company of Virginia, and Central Telephone Company of Texas. The Minnesota and Iowa divisions of Central Telephone Company were sold to Rochester Telephone Corporation in 1991. Centel's Ohio operating company was sold to Century earlier this year.

[35] Central Telephone Company has a limited number of shares of preferred stock which is held by individuals other than Centel Corp. These shares equal less than 3% of the voting power in the company, and to the extent there is any market in these shares, it is extremely limited.

Indeed, requiring individual telephone companies to disgorge overearnings while other companies bear their losses will assure that the telephone operators earn less than the rate of return the Commission has concluded is necessary to assure the inflow of capital.

III. CONCLUSION

Centel supports the Commission's efforts to streamline the interstate rate of return represcription process. The recommendations set forth herein represent reasonable improvements on the Commission's proposals and will eliminate costly and unnecessary rate prescriptions. The recommendations will also provide LECs with a fair opportunity to earn the authorized rate of return.

Respectfully submitted,

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EXHIBIT 1

Regression Analysis of Aa Utility Bond Yields and Risk Premiums (a)

		(a) AA Utility Yield	(b) Median DCF Lower Half S&P 400	(c) Risk Premium (b−a)
1982	1st	15.57%	18.34%	2.77%
	2nd	15.78%	17.94%	2.16%
	3rd	13.92%	17.26%	3.34%
	4th	12.76%	16.18%	3.42%
1983	1st	12.67%	15.94%	3.27%
	2nd	12.64%	15.76%	3.12%
	3rd	13.04%	15.92%	2.88%
	4th	13.14%	15.68%	2.54%
1984	1st	13.66%	16.03%	2.37%
	2nd	14.90%	16.36%	1.46%
	3rd	13.43%	16.22%	2.79%
	4th	12.76%	15.27%	2.51%
1985	1st	13.50%	15.24%	1.74%
	2nd	11.68%	14.73%	3.05%
	3rd	11.68%	14.48%	2.80%
	4th	10.57%	14.07%	3.50%
1986	1st	9.16%	13.58%	4.42%
	2nd	9.36%	13.35%	3.99%
	3rd	9.28%	13.16%	3.88%
	4th	8.81%	12.94%	4.13%
1987	1st	8.64%	12.66%	4.02%
	2nd	9.61%	12.85%	3.24%
	3rd	10.66%	12.80%	2.14%
	4th	10.78%	13.55%	2.77%
1988	1st	9.92%	13.28%	3.36%
	2nd	10.52%	13.37%	2.85%
	3rd	10.34%	13.42%	3.08%
	4th	9.90%	13.49%	3.59%
1989	1st	9.96%	13.46%	3.50%
	2nd	9.73%	13.27%	3.54%
	3rd	9.28%	13.13%	3.85%
	4th	9.26%	13.19%	3.93%
1990	1st	9.52%	13.22%	3.70%
	2nd	9.75%	13.11%	3.36%
	3rd	9.75%	13.48%	3.73%
	4th	9.59%	13.95%	4.36%
1991	1st	9.26%	13.37%	4.11%
	2nd	9.19%	13.04%	3.85%
	3rd	9.09%	13.09%	4.00%
	4th	8.83%	13.07%	4.24%
1992	1st	8.59%	12.86%	4.27%

(a) Data from Exhibit D of FCC Docket 92−133.

Aa Utility Yield as Predictor of Risk Premium

Regression Output:

Constant		0.064022
Std Err of Y Est		0.004434
R Squared		0.636383
No. of Observations		41
Degrees of Freedom		39
X Coefficient(s)	−0.28161	
Std Err of Coef.	0.03409	
T−Value	−8.261697	

Linear Regression Formula:

$y = ax + b$

Where:

y = Equity Risk Premium over Aa Utility Bonds
a = Aa Utility Bond Yield
x = X Coefficient, or factor by which the equity risk premium moves in relation to the Aa Utility Bond Yield.
b = Constant Value, or the equity risk premium assuming the (ax) value equals zero.

Based on data from the adjoining table, the formula for equity risk premiums relative to the Aa Utility Bond Yield is:

$y = -.28161(a) + .064022$

or, since the table is in percentages,

$y = -.28161(a) + 6.4022\%$

For example, using an Aa Utility Bond Yield of 9.00%, the equity risk premium would be:

$-.28161(9.00\%) + 6.4022\%$ or 3.8677%